



**Investment Office**

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September 11, 2006

**AGENDA ITEM 8**

**TO: MEMBERS OF THE INVESTMENT COMMITTEE**

- I. SUBJECT:** Policy Subcommittee Report
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:** CONSENT:
- a. Real Estate Policy
    - 1) Revision of Global Public Real Estate Equity Securities (Global PREES)
  - b. Equity Policies
    - 1) Repeal of Passive Domestic Small Capitalization Equities – Externally Managed
    - 2) Revision of Corporate Governance Principles and Guidelines
  - c. Miscellaneous Policies
    - 1) Revision of Asset Allocation Strategy
    - 2) Revision of Self-Funded Healthcare
- IV. ANALYSIS:**

The Policy Subcommittee met on August 11, 2006 and discussed or acted on the following:

- A. Policy Review Project Update – At the July 2006 Board offsite, staff provided a briefing on the delegations portion of the project. The Board was presented with a matrix summarizing current delegations by subject matter and asset class. Based on the discussion and the guidance received from the Board, and subsequent discussion with the Legal and Compliance Offices, staff presented the Policy Subcommittee with revisions to the scope of the delegations portion of the project, as well as a timeline for moving forward.

- B. Revised Policies – The Subcommittee recommends that the Investment Committee approve the attached revised policies.

The policies are black-lined versions from the last adopted policy by the Investment Committee. The black-line uses strike-out to indicate deletions and double underline to indicate additions. Single underline does not indicate a change; rather, it indicates that the term is defined in the glossary.

- **Item 8a – Real Estate Policy**

- 1) Revision of Global Public Real Estate Equity Securities (Global PREES)**

The Global PREES Statement of Investment Policy currently is silent on the issue of short selling. Staff recommends that we revise the policy to be clear that it allows short positions in the portfolio if the portfolio is externally managed and if staff and CalPERS' consultant determine that the external manager has the requisite expertise to manage short positions.

- **Item 8b – Equity Policies**

- 1) Repeal of Passive Domestic Small Capitalization Equities – Externally Managed**

On August 18, 2003, the Investment Committee approved moving the externally managed passive small capitalization portfolio to an internally managed portfolio. This action made the Passive Domestic Small Capitalization Equities – Externally Managed Policy obsolete; staff requests that the policy be repealed. The current internally managed small capitalization portfolio is covered by the Statement of Investment Policy for Equity Index Funds – Internally Managed Policy (copy attached).

- 2) Revision of Corporate Governance Principles and Guidelines**

At the June 20, 2006 meeting, the Investment Committee directed staff to amend CalPERS' Corporate Governance Core Principles & Guidelines (Principles) to address recent issues relating to stock option backdating. This agenda item seeks Committee approval to amend Appendix D, Executive Compensation Policies, of CalPERS' Principles by adding the following provision:

Expected equity grant issue dates should be pre-established, set, and disclosed by the compensation committee. Realized grant dates should be publicly disclosed at the latest on the day following the date of grant. The rationale for any amendment to pre-established grant dates should be disclosed with justification describing how the amendment benefits shareowners.

- **Item 8c – Miscellaneous Policies**

- 1) Revision of Asset Allocation Strategy**

This revision of policy allows for using derivatives to implement overlay strategies with the effect of reducing average cash balances and increasing asset class investments. The amount of leverage associated with derivative positions will be monitored to ensure that leverage in excess of total plan assets does not occur. This application of derivatives is restricted only to managing cash balances and does not represent a significant increase in the use of derivatives.

The Policy Subcommittee requested that staff also make additional changes to the leverage section of the policy. Specifically, changes related to monthly monitoring and the inclusion of a guideline that any leverage should not exceed \$500 million.

Staff will provide an update of cash-related glossary terms at the next Policy Subcommittee meeting.

- 2) Revision of Self-Funded Healthcare**

When the Self-Funded Healthcare Program transitioned from the State Treasurer's Office to CalPERS, investment staff proposed greater potential returns by finding a longer term benchmark but was concerned about liquidity requirements.

Healthcare staff looked at core fund levels to determine if funds could be invested farther out in the yield curve for greater potential return, and determined that there were core funds of significant amounts.

Wilshire recommended changing from a short term benchmark to an intermediate term benchmark. The Self-Funded Healthcare Policy has been significantly amended to reflect the changes in the benchmark.

**V. STRATEGIC PLAN:**

This item supports Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

**VI. RESULTS/COSTS:**

The results of this item will provide the System with enhanced efficiencies and ability to manage the overall portfolio.

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Division Chief

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